

AUDIT REPORT

ROAD MAP TO EXCELLENCE IN CONTRACTING



EXECUTIVE OFFICE OF THE GOVERNOR
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EXECUTIVE SUMMARY

Next year, a significant portion of Florida's projected \$54 billion budget will be spent on contracted services, ranging from highway construction to medical care. Many of these services are "outsourced" simply because the state lacks the staff and equipment to perform them on a large scale. In recent years, state leaders also have begun embracing outsourcing as a cost-saving alternative for functions traditionally performed by state employees, ranging from managing human resources to feeding prisoners.

As these functions are outsourced for the first time, additional oversight and accountability are required to ensure the expected savings are realized, and that, ultimately, Florida taxpayers receive a fair return on their tax dollars. In years past, the Florida Legislature enacted a series of statutes designed to tighten control over the spending process. To monitor compliance with these statutes, a system of internal auditing was implemented within each state agency.

This report examines the effectiveness of existing controls over contracting as measured by approximately 100 audits at seven Governor's agencies, identifies the risks inherent to those controls, and offers recommendations for improving accountability and better protecting the state's interest. To validate the risks and recommendations presented in this report, we discussed them with procurement managers at the seven agencies. Their collective comments generally supported the auditors' conclusions and were used to shape the final report.

As documented in almost 500 audit findings over a three-year period, controls over contracting are in a state of disrepair. The existing patchwork of statutes and rules, which evolved over many years, has failed to provide effective and consistent guidance in the contracting process to state agencies. Auditors repeatedly found inconsistent guidelines and practices in an environment that fails to encourage improvement. For example, staff assigned to contract with vendors too often lack the training and experience needed to obtain the best deal for the state. And there is no statewide system for logging vendor performance and sharing that information with other agencies as a measure for determining whether to contract with a particular vendor. While auditors did find effective practices in use within some agencies, there appears to have been no effort to share these best practices with their external agency counterparts. The following table shows a breakdown of the 497 audit findings.

HISTORICAL AUDIT FINDINGS BY CORE CONTRACTING ACTIVITY	
performance monitoring	45%
procurement methodology	20%
contract writing	17%
payment	10%
needs assessment	7%
contract closure	1%

An example of the effects of poor inter-agency communication is evidenced in the State's recent execution of an e-procurement contract designed to streamline the

procurement process. The new e-procurement system, while possibly a step in the right direction, appears unlikely to address significant procurement issues. State procurement managers repeatedly told us they had no input in the formulation of the e-procurement proposal, and a vendor representative indicated the new system was not designed to address control issues such as those described in this report.

This report analyzes findings and recommendations made by agency Inspectors General, the Auditor General, and OPPAGA regarding the procurement process. These findings and recommendations focused on past history. Our methodology did not consider re-engineering the procurement process.

The State's future vision for the procurement function should be defined and planned on an enterprise level while integrating appropriate business rules, user requirements, and up-to-date technology.

We believe implementation of our recommendations can make significant improvements whether the procurement system remains as it is or if enhancements are made.

A PLAN TO PROTECT FLORIDA'S INVESTMENT IN CONTRACTED SERVICES

Next year, Florida will spend billions on contracted services. Oversight and accountability are needed to ensure taxpayers receive optimum return for these substantial investments. This report was prepared with this goal in mind.

To promote efficient and economical expenditure of contracted funds, the Florida Legislature over the years enacted statutory restraints and safeguards such as requirements for competitive bidding and contract monitoring to help ensure the state receives fair value for its taxpayer dollars. Statutes also authorize audits to prevent, detect and correct abuses that could result in waste, fraud or misuse of state funds. The results of those audits are the foundation of this report.

This ***Roadmap to Excellence in Outsourcing*** is presented in four phases:

- It provides an overview of recurring contract-related deficiencies identified during recent audits of seven Governor's agencies.
- It then identifies contributing factors risking state resources to loss, waste, and misuse affecting economy, efficiency and effectiveness of programs and services.
- It then makes recommendations to promote accountability economy and efficiency in contracting.
- And finally, the Department of Management Services (DMS) responded, indicating agreement and the actions to be taken.

How This Report Was Prepared

Auditors from seven Governor's agencies, as described later in this report, were brought together to examine the condition of agency practices related to contracting for state services, to identify problem areas, and to suggest ways to correct any systemic weaknesses.

This team, guided by the Governor's Chief Inspector General, reviewed approximately 100 audits conducted at the seven agencies since July 1999 and extracted 494 contract-related audit findings. The team then identified six core activities instrumental to outsourcing: needs assessment, procurement methodology, contract writing, performance monitoring, payment and contract closure. We categorized findings by core activity, identified common risks and developed steps to mitigate these risks.

To validate our interpretation of the processes and associated risks, we presented our assessment and recommendations to contracting managers at the seven agencies. Management confirmed our interpretation and helped us to refine recommendations to mitigate risks.

Based on the above interviews and analysis, we determined that significant changes were needed in state contracting practices.

Assessment of Current Conditions

Statistically, the majority of problems identified by auditors over the last three years fall into three of the core activities: performance monitoring (45 percent), procurement methodology (20 percent), and contract writing (17 percent). Less prevalent were problems in the following core activities: payment (10 percent), needs assessment, (7 percent) and contract closure (1 percent).

The core activities and associated risks are listed below in order of frequency of occurrence:

1. **Performance Monitoring.** This area typically involves oversight of the contractor's performance by agency personnel. Problems in this area were by far the most common source of audit findings (45 percent). Risks included financial losses to the state, failure to obtain desired performance by the contractor, payment for defective deliverables, fraud and loss of funding sources.
2. **Procurement Methodology.** The way agencies choose contractors is governed by a myriad of statutory mandates which attempt to ensure the selection process provides both the best value to the state and fair and open competition to vendors. These overlapping mandates create loopholes and confusion, contributing to this core activity's prevalence. Risks include diminished competition, limited availability of commercial sources and failure to obtain desired performance due to selection of less-than-optimal vendors and contractors.
3. **Contract Writing.** Contract documents must be clear, complete, and unambiguous to properly protect the interests of the state and to ensure that both parties clearly understand their respective obligations. Errors or omissions in the contract often surface as potholes in the road to service delivery. Risks include disadvantageous agreements, lost time, waste, failure to obtain desired performance, inability to enforce contract terms, and loss of funding resources.
4. **Payment.** Vendor payment is probably one of the most highly regulated parts of the contracting process, but even so, errors in this area accounted for 10 percent of all audit findings. The primary risk in this area is of course payment errors, which usually involve release of funds without verification or authorization. Managers should not pay for inadequate or incomplete goods or services, but they routinely do.
5. **Needs Assessment.** Though surfacing in only 7 percent of all findings, this area is one of the most important steps to ensure successful contracting. Before the first dollar is even earmarked for expenditure, the agency must ensure that the product or service solicited is one that best meets the agency's needs. Needs assessment documentation is more difficult to trace, and its qualitative nature often makes it more difficult to produce a definitive judgment as to its effectiveness. Auditors and managers alike agree that needs assessments should be strengthened to mitigate significant risks such as purchase of incorrect or unneeded deliverables, goods or services that are incompatible with existing resources, waste and inappropriate use of resources.
6. **Closure.** As this area accounts for only 1 percent of findings, it receives only brief mention here. The primary risk is failure to obtain desired performance due to closure of the agency-vendor relationship prior to satisfactory completion of the contract.

Contributing Factors

The above assessment points to a pressing need to bolster controls over the contracting process – a move mutually supported by auditors and agency managers. Managers also helped us to identify contributing factors of recurring contracting deficiencies. There is consensus that the following cause-and-effect relationships exist within the current system:

Piecemeal statutes and rules. Current statutes and rules were developed piecemeal over time to address specific abuses and concerns rather than to establish a comprehensive and cohesive statewide procurement/contracting system. Consequently, poor contracting practices have resulted from fragmented implementation and inadequate procedures over purchasing mechanisms such as state term contracts and invitations to negotiate.

We recommend an initiative, led by DMS and a core group of procurement staff, to monitor outsourcing practices for inadequacies and inconsistencies, and propose improved legislative and regulatory changes. This process, over time, could replace the myriad of overlapping and conflicting statutes and guidelines with one unified, effective system of controls.

Response - We agree with the recommendation. DMS has begun, and will continue, efforts to streamline the state's procurement laws. Throughout 2001-2002, we worked closely with other state agency procurement staff and the Florida Legislature to enact and implement Chapter 2002-207, Laws of Florida. This major revision of Chapter 287, Florida Statutes, eliminated many of the inconsistencies and ambiguities that have accrued in the statute over the past twenty years.

Additionally, in October 2002, DMS contracted for development of a statewide electronic procurement system, called MyFloridaMarketPlace. This system will significantly improve and streamline procurement processes across the state enterprise by, among other things, incorporating private sector best practices. In the current development of the system's functionality, DMS has solicited and received input from the agencies. We will continue to work with the agencies to align the purchasing rules with the system and best practices. To implement these amendments, we intend to initiate formal rulemaking in the second half of 2003.

DMS will continue to coordinate with other state agency procurement staff and the private sector to review existing state and federal procurement laws and regulations. Our goal will be to propose an overhaul of Chapter 287 and changes

to the existing rules and guidelines that will result in a consistent and unified system of procurement controls. Statutory changes will require legislative approval, a process that may take a minimum of 18-24 months to fully develop and implement.

Lack of Statewide Guidance. The lack of centralized statewide direction in the procurement area has led to inconsistent and deficient contracting practices both among and within agencies. DMS is statutorily responsible for providing uniform contractual service procurement policies, rules and procedures. However, most agency managers interviewed felt that DMS essentially had abdicated that responsibility. Agencies could not obtain accurate guidance or approval for procurement actions in a timely manner. A contributing factor is that DMS has had four different directors or acting directors in charge of State Purchasing during the last 16 months.

We recommend that DMS accept the mantle of leadership bestowed by Florida Statute. Section 287.032, F.S., states that the purpose of DMS is: "...to promote efficiency, economy...; to effect coordination in the purchase of commodities and contractual services for the state; and, to provide uniform commodity and contractual service procurement policies, rules, procedures, and forms for use by agencies and eligible users...." Most deficiencies could be readily addressed and resolved by requiring that DMS embrace its statutory mandate.

Response - We agree with the recommendation. DMS is currently in the process of filling the Purchasing Director's position on a permanent basis and has renewed focus on and commitment to its role as the state's lead agency in purchasing and to providing the utmost in service to its stakeholders. As such, DMS will ensure that appropriate direction is provided to state agencies in all procurement and contracting matters.

There is no statewide system to train or certify agency contracting personnel, nor

[are there incentives to encourage professional development.](#) Some state agencies have implemented internal training programs for contract managers and contract monitors, but such implementations are sporadic. They range from an occasional class to a series of creditable classes where a certification might be issued. Several national organizations and states promote the procurement profession and sponsor certification programs. The National Institute of Governmental Purchasing, Inc. offers several certification programs for procurement professionals (Certified Public Procurement Buyer and Certified Public Procurement Officer). The state of Massachusetts offers a curriculum leading to the Massachusetts Certified Public Purchasing Official designation. We believe Florida has failed to maximize the skills and abilities of procurement staff by not offering incentives or encouragement for professional development.

We recommend a statewide training initiative led by DMS be undertaken using the foundation developed in some agencies. In addition, we recommend incentives to encourage professionalism and certification for contract administrators, negotiators, monitors and managers.

Response - We agree with the recommendation. DMS's newly created Office of Organizational Development, in coordination with other state agencies, will assess the training needs of contract personnel and determine whether it would be more practical to create a state-sponsored training program or utilize established industry programs. If it is determined that a state-sponsored training program is preferable, establishment of a professional development program will be coordinated with procurement staff of the various state agencies. In either case, DMS will also determine how best to use incentives to encourage professionalism and certification for contract personnel. We note that any program to offer such employment incentives will likely require legislative approval. It can be expected that such legislation, if approved, will require a minimum of 18-24 months to fully develop, incorporate into statute, and implement.

[The state's corporate culture does not foster](#)

[the sharing of best contracting practices among agencies.](#) In our conversations with the agency managers, we found varying degrees of sophistication in the manner in which tasks were performed. Some systems developed by agencies appear to be outstanding and could benefit all. For example:

The Department of Transportation developed and uses a Web-based invoicing system to pay vendors. Transportation staff advised this has greatly reduced routine errors and processing time, and is a benefit to both vendors and the Department.

Likewise, the Department of Children and Families has developed a comprehensive on-line information system to aid in the initial contract writing process, and the monitoring, oversight and tracking of contractor performance. Sections include specific guidance on contract writing, managing, and monitoring as well as professional development.

Without a clearinghouse to share innovative ideas, and absent collaborative methodology when initially designing systems, the benefits are minimal to the enterprise.

We recommend that DMS create and foster user groups of professional procurement staff that meet on a regular basis to share best practices and common problems. Output from this group could be used to spearhead changes in legislation and policy direction.

Response - We agree with the recommendation. In conjunction with implementing MyFloridaMarketPlace, DMS has begun conducting regular meetings with "super user" groups of procurement and other staff from both state agencies and from vendors. DMS posts the meeting materials on the MyFloridaMarketPlace website. Over time, the focus of the agency meetings is expected to shift away from purely systemic issues and toward best practices and other common procurement issues, including legislative and policy changes.

[Agencies' use of different processes and procedures in awarding and managing contracts causes the contract documents to vary considerably in format and content.](#)

This lack of consistency makes information exchange, document reviews and information comprehension extremely difficult. A first step in facilitating the exchange of information could be to develop a uniform contract format. By providing consistency in the layout and location of key provisions, this would:

- simplify reading and interpretation of contracts for private industry, contract managers and contract reviewers;
- shorten cycle times associated with preparation, review, and approval of contract documents. Contract managers would know precisely where to locate clauses and provisions, reviewers would know where to find information, and vendors could better understand contracts drafted by any agency;
- enable implementation of common core training, leveraging economies of scale; and,
- facilitate the movement of personnel among agencies within the contracting career field, thus expanding their career ladder and providing a more stable professional workforce.

We recommend DMS, with the assistance of other agencies, develop standard contract formats for use by all state agencies. The standard contract should encompass the above-referenced information.

Response - We agree with the recommendation. DMS currently mandates, by rule, use of standard forms in all competitive solicitations (see Chapter 60A-1.002(7) and 1.008(2), Florida Administrative Code). In coordination with state agencies, DMS will revise these forms, and develop new forms and standard contract provisions, as part of the formal rulemaking planned for the second half of 2003. To the extent practicable, the standard forms and contracts will be available within MyFloridaMarketPlace for agencies to select and use as applicable. While many of the standard forms and contract terms will have universal application in simple procurements, they cannot be all encompassing. However, in many instances, they will serve as useful guides for agencies when developing more complex procurement contracts.

Inadequate systems exist for monitoring and rating vendor performance. Systems for properly monitoring and rating vendor performance are inadequate or non-existent. Presently, there is no uniform requirement in Florida law for an agency to monitor the performance of its contractual service providers or prepare a closeout document to rate vendors' performance. There is sporadic guidance in federal regulation and selected statutes. Also, there is no requirement for prospective procurers to consider other agencies' prior experience with a vendor. Consequently, vendors with inadequate performance may receive additional contracts because there is no system to capture performance results and incorporate these results into the selection process. Under the existing system, only in the event of default may a contractor's performance be considered in future bids. In effect, a contractor may be suspended from doing business with the state only after the contractor has failed to perform. However, a system of rating contractors on previous contract performance would ensure that the contractor's performance history is known and is considered during the bid evaluation process.

We recommend a uniform vendor monitoring and rating system be created which incorporates links to contract monitoring reports, vendor websites, closeout evaluations, and a method for other agencies to access performance evaluations. Where possible the monitoring should be performed by employees who are independent of the earlier actions taken to award or manage the contract.

Response - We agree with the recommendation. With assistance from the other state agencies, DMS will consider ways to develop and implement a uniform vendor monitoring system. One alternative that could be implemented is a standard questionnaire for agencies to rate vendor performance. The questionnaire could be incorporated as a functional part of the MyFloridaMarketPlace. User ratings would become part of the vendor's history file and would be available for review by all users. DMS

will immediately begin soliciting input from the agencies in conjunction with MyFloridaMarketPlace "super user" meetings to determine the appropriate rating criteria. Once determined, DMS will incorporate the vendor monitoring system in its purchasing rules and will work to include vendor monitoring functionality in MyFloridaMarketPlace by April 2004, at which time all executive agencies will be processing procurements through the system.

A formal procedure for agencies to perform and document needs assessments has not been developed by DMS. Section 287.042(3)(d), F.S., requires DMS to develop procedures for agencies to use when making initial contracting decisions. These procedures should include identifying and assessing, in writing, project needs and requirements, availability of agency staff, budgetary constraints, facility and equipment availability, current and projected agency workload capabilities and the ability of other state agencies to perform the services. These requirements relate to the performance of a needs assessment prior to contracting with a vendor. This lack of formal guidance has resulted in additional project costs and purchases of unnecessary or incompatible goods or services.

We recommend DMS fulfill the statutory mandate to develop formal procedures for agencies to perform and document needs assessment.

Response - We agree with the recommendation. With input from purchasing and administrative experts in the state agencies, DMS will develop procedures for agencies to perform and document needs assessments prior to acquiring goods or services. The requirement that a needs assessment be performed should be triggered by a minimum dollar threshold that corresponds to the thresholds already established in statute and rule. It is anticipated that this requirement will be incorporated into the MyFloridaMarketPlace system by April 2004, at which time all executive agencies will be processing procurements through the system.

Lack of Expertise in Negotiating Contracts. The state uses a process of contract

negotiation similar to the federal government. There are numerous safeguards in the federal model that is not included in the state model. The federal Truth in Negotiations Act (TINA) requires a bidder to show the cost, overhead, and profit associated with the contract. The federal government went through many years of debate prior to passing the Truth in Negotiations Act. This places both parties to the contract on an equal footing. In most cases, the state has no such requirement. State contract negotiators generally do not have this information and rely on the contractor's representations to determine contract pricing. In addition, the state seldom performs cost analyses prior to entering negotiations. Cost estimates would assist negotiators in determining whether contractor proposals are reasonable. In general, managers with limited knowledge or experience in procurement are negotiating with contractors' veteran negotiation teams, particularly for service contracts.

We recommend that legislation be proposed similar to the Truth in Negotiations Act to assist contract negotiators in determining whether the contractor's proposal is reasonable.

We also recommend that DMS immediately begin to offer a negotiating training program for state employees.

Response - We agree with the recommendation. Requiring contractors to provide cost and pricing data would assist the State in determining whether proposals are reasonable. In order to implement this recommendation, legislative action will be needed to provide public records exemption for cost and profit information provided by contractors. Under Florida's current public records laws, detailed cost and profit information in contractors' proposals would be available to competitors. This might result in a reduced number of bidders, and thus, competition. It can be anticipated that such legislation would take a minimum of 18-24 months to implement.

In the meantime, in coordination with other state agencies, DMS will develop and implement a

contract negotiating training program for state procurement employees.

Conclusion

In order to successfully implement the above recommendations, we ask that the Governor's Office:

1. Appoint a point person to review this report and its supporting documentation
2. Draft the directives needed to implement those recommendations authorized under existing legislation
3. Draft legislation, as needed, to enable implementation of those recommendations requiring statutory changes
4. Track the implementation process and report its progress to the Governor

Past efforts to address these problems have failed largely due to a lack of consistent policy implementation and enforcement. We believe that the above recommendations will improve accountability at a time when it is needed most due to increasing demands for services and diminishing funds.

METHODOLOGY and SCOPE

We reviewed approximately 100 audit reports from seven different agencies, the Auditor General and OPPAGA. These reports were issued during the three-year period from July 1999 through June 2002

and included 494 findings dealing with the procurement, contracting and outsourcing process.

During the audit we relied upon the work done by the individual agencies and followed appropriate audit standards issued by the Institute of Internal Auditors for the remainder of the audit work. Since each of the agencies, except the Auditor General and OPPAGA, had members on our team we considered that adequate testing of the agencies work was done in order to place reliance on it.

This audit was requested by Governor's Chief Inspector General, Derry Harper, and was directed by Jim Thomas and Jerry Chesnutt. The audit team was made up of auditors from Inspectors General offices from the following agencies: Executive Office of the Governor, Department of Children and Families, Department of Corrections, Department of Education, Department of Juvenile Justice, Department of Management Services and Department of Transportation. Auditors that participated in the audit were Kathryn Parker, Patricia Manning, Monica Herz, Cynthia Bedenbaugh, Bob Macmaster, Lisa Stokes, Lorrie Stanford, Steve Stolting, Steven Meredith, Cassandra Jenkins, John W. Davis, Sandy Lipner, Ronnie Atkins, and Molly Eichhoefer.

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